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RUEHSG/AMEMBASSY SANTIAGO 0214
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RUEHUL/AMEMBASSY SEOUL 0194
RUEHTV/AMEMBASSY TEL AVIV 0031
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FOR WHA/CEN TELLO

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TAGS: ECON EFTA ETRD EWWT FCSC PM
SUBJECT: PANAMA CANAL AUTHORITY EYES TOLL INCREASES

REF: A. PAMAMA 2374
¶B. PANAMA 2375

¶1. SUMMARY. On December 18, 2006, DCM and EconOff met with Panama Canal Authority (ACP) Administrator Alberto Aleman Zubieta and ACP Chief of Planning Javier Sabonge to discuss the ACP's planned toll increases. The ACP has not yet determined the magnitude of the toll increases. Aleman hinted that the increases could be as high as 8.0% per annum over the next five years. Concerned about potentially adverse USG reaction to any toll increases, Aleman sought to soften possible opposition by suggesting such increases should be of no concern to the USG. Aleman said the Miami-based cruise industry will complain as they did after the 2002/2003 toll increases. END SUMMARY.

ACP May Front-Load Canal Toll Increases

¶2. (SBU) On December 18, 2006, DCM and EconOff met with Aleman and Sabonge to discuss the ACP's planned toll increases. Aleman told EmbOffs the ACP has not yet determined the magnitude of the toll increases. Aleman said, however, that the increase would be in excess of the 3.5% discussed during the runup to the October 2006 referendum on the $5.25 billion Panama Canal expansion project (Project). He also hinted that the increases could be as high as 8.0% per annum over the next five years. While never committing to an actual toll increase figure, the ACP's public discourse during the Project debate was that annual toll increases would be between 3.5% and 8.0%. ACP Project Manager Jorge de la Guardia separately told EmbOffs that the ACP plans on implementing toll increases during the first quarter of 2007. See reftel A.

¶3. (U) Since the start of the Project debate in April 2006,

the ACP has consistently stated that its goal was to (i) raise tolls 100% by 2025 (hence the 3.5% annual toll increase figure) and (ii) finance the Project through a combination of toll increases and debt. Aleman said the ACP may raise tolls higher than 3.5% in the short run in order to incur less indebtedness. Publicly, the ACP has stated that $2.3 billion of the $5.25 billion Project costs would be financed with debt. ACP Chief Financial Officer Jorge Barrios Ng told EmbOffs in a December 6 meeting that the ACP might boost the Project's debt to $2.5 billion. See reftel B.

ACP Girds for Pushback by Users

¶4. (SBU) The ACP is concerned about potential adverse USG reaction to any toll increases. The December 18 meeting was part of the ACP's efforts to keep Post apprised of the toll increases situation in order to avoid, or soften, USG opposition. Aleman said he expects significant protests from countries such as Japan, Ecuador, Peru and Chile, as each country protested the 2002/2003 toll increases. In preparation for such protests, Aleman is saying the ACP is paying for the Project, not the users. He said the users are simply paying for the services rendered by the canal. Aleman argues that the ACP is assuming all risk in the Project since the users are under no obligation to use the canal once expanded. To date, the GOP and ACP assuaged public concerns over who would pay for the Project by saying it would be partially funded by the users through increased tolls.

¶5. (SBU) Aleman said the toll increases should be of no concern to the USG. Aleman added that canal tolls are the lowest costs in shipping goods. Aleman said it costs $600 to transport a container across the U.S. The ACP charges $54 per container. Even if the price doubles to $108 overnight, Aleman says the incremental cost per item transited is minimal

¶6. (SBU) Aleman said the Miami-based cruise industry will complain as they did after the 2002/2003 toll increases. Aleman believes the cruise industry will simply pass the costs through to the passengers. Aleman said the canal is the second most popular cruise destination after Alaska and the cruise industry cannot afford to curtail cruises to Panama. Aleman said he is willing to work with the cruise industry to time the toll increases in such a manner which will facilitate the industry passing the costs to the passengers.

ACP Toll Pricing Philosophy

¶7. (SBU) Aleman said the ACP's pricing philosophy is to charge what the canal is worth to each user and to charge based on a ship's cargo carrying capacity. Unlike during the USG administration where tolls were applied more uniformly, the ACP seeks to price each user based on the price elasticity of that user. Therefore, the ACP will, for example, charge liner services (cruise, container and vehicle ships) which operate on tighter schedule more than grain ships which have a more flexible timetable. Aleman said if oil prices continue to rise, the canal's value will increases and he will be able to raise tolls even further. However, he said he realizes that once he charges "one penny more than the value received by its users, they will go elsewhere." Aleman also said the ACP will not disclose the uses of any toll increases. He said that the cost to operate and expand the canal is no concern of the users. Under USG administration, the toll structure was geared towards covering operating costs and capital expenditures, accordingly any toll increases were justified to the users by disclosing the uses of such toll increases.

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Comment: Toll Hikes Driven by Politics, Not Just Market
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¶8. (SBU) Aleman and the ACP officials have an encyclopedic

knowledge of the shipping industry. They have extensive research on the costs of structure of the canal users and understand the dynamics of any toll increase. Aleman also knows that with global trading increasing, particularly containerized traffic, and with increased fuel costs, the canal services are in great demand. He knows he is in an excellent bargaining position. However, he also understands that either changes in the world economy or extraordinary events (such as a drought which would limit the number of possible transits) could adversely effect the canal's financial situation. Aleman's stated rationale of increasing tolls by as much as 8.0% annually in order to lessen the debt burden is contrary to matching the duration of the Project or the canal's operation with the duration of its long term debt. The ACP's return on assets was 18.8% during 2006. The yield on GoP's most recent long term bond issuance was 6.729%. From a strictly financial point of view, it would make more sense for the ACP to incur more long term debt, not less. The real reason for the hesitancy to incur greater debt appears to be political. The ACP needs to assuage the public's concerns about increased public debt. The ACP's real reason for higher toll increases appears to be market driven. The ACP knows the canal's services are currently in great demand and it therefore has pricing power. The higher toll increases will also limit the increased financial risk imposed on the canal by the Project. By increasing tolls 8.0% annually beginning in 2007, the ACP would double tolls by 2015 instead of 2025. Increasing tolls by 8.0% annually for five years and 3.0% thereafter would double tolls by 2020. The higher toll increases in the early years would increase the present value of the future cash flows which will help in lowering the interest expense on any Project debt financing.
Eaton